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Department of Accounting

Master's thesis:

"Factors Influencing the Pricing of Audit Fees: An Empirical Examination"

"العوامل المؤثرة في تسعير أتعاب التدقيق: دراسة ميدانية"

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تقرير اللجنة

"Factors Influencing the Pricing of Audit Fees: An Empirical Examination"

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اعداد:

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قدمت هذه الرسالة استكمالا لمتطلبات الحصول على درجة الماجستير في تخصص المحاسبة في جامعة اليرموك, اربد, الاردن.

وافق عليها

الاستاذ الدكتور ميشيل سعيد سويدان مشرفاً ورئيساً ....

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Table of Contents

List of Tables

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Abstract

YazanAbuanzeh. "**Factors Influencing the Pricing of External Audit Fees**: **An Empirical Examination"**Master Thesis in Accounting, Yarmouk University. 2014**.**

(Advisor: prof. Mishiel Said Suwaidan)

The study aims to investigate factors influencing the pricing of external audit fees (corporate size, corporate risk, corporate complexity, time lag between year-end and the audit report date, size, experience and reputation of audit firm) in Jordanian manufacturing companies. The sample of the study consisted of 66 manufacturing companies listed on Amman Stock Exchange over a three years period (2011-2013). To achieve the objectives of the study a multiple regression model incorporating a number of independent variables and audit fees as the dependent variable, was used to analyze the data collected from the annual report of each company. Findings indicate that the size of both the company and the audit firms are the most important factors in determining the pricing of audit fees. The study ended with recommendations for future research that may cover other aspects of the topic and/or covering other sectors in the Jordanian market.

Keywords: External auditing, Audit fees.

" العوامل المؤثرة في تسعير أتعاب التدقيق: دراسة ميدانية"

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(الملخص)

هدفت هذه الدراسة لمعرفة اثر بعض العوامل (حجم الشركة و درجة تعقيد عملياتها و مخاطر التدقيق، الفترة الزمنية بين انتهاء السنة المالية و اصدار تقرير المدقق الخارجي، حجم مكتب التدقيق و خبرته و سمعته) على اتعاب التدقيق الخارجي في الشركات الصناعية الأردنية . تكونت عينة الدراسة من 66 شركة صناعية مدرجة في بورصة عمان على مدى ثلاث سنوات (2011-2013). لتحقيق اهداف الدراسة تم تطوير نموذج للانحدار المتعدد تضمن العديد من المتغيرات المستقلة و أتعاب التدقيق كمتغير تابع. أظهرت نتائج التحليل ان حجم الشركة و حجم مكتب التدقيق هما اهم العوامل المحددة لاتعاب التدقيق الخارجي. وقد تم انهاء الدراسة بالتوصية لاجراء المزيد من الدراسات الاردنية التي تأخذ بعين الاعتبار متغيرات اخرى لم يتم تغطيتها في الدراسة الحالية كتأثير الوضع التنافسي بين مكاتب التدقيق على اتعاب التدقيق التي يتقاضونها. ومن الممكن عمل دراسات اخرى مطابقة للدراسة الحالية مع تطبيقها على القطاعات الاخرى الموجودة في بورصة عمان.

Chapter One
Introduction

1.1 Introduction

1.2 Objectives of the Study

1.3 Questions of the Study

1.4 Importance of the Study

1.5 Organization of the Study

1.1 Introduction

Audit fees can be defined as the price the company pays the external auditor in exchange of his/her audit services. The determination of the audit fees is based on the contract between the auditor and the auditee in accordance with time spent on the audit process, the service required, and the number of staff needed for the audit process. It should be mentioned that audit fees are normally determined before starting the audit process (El-Gammal2012). Over the past decade the pricing of audit services and the determinants of audit fees have been a very interesting subject for many researchers. This is because the most important problem faced by external auditors and their clients is determining the proper audit fees that are acceptable by both sides. On the one hand, auditors believe that the fees they get are very low compared to the costs of providing the audit services and the importance of these services. On the other hand, auditees believe that there are exaggerations in the audit fees (AbuNassar, 1999). According to Abu Nassar(1999) unfair pricing of audit services could force skilled and competent auditors to quit auditing, thus the quality of audit services would go down. To help minimize this problem of unfair pricing and severe competition between audit firms, the Jordanian Association

of Certified Public Accountants (JACPA) in 2001 put a minimum audit fees for auditing public companies of JD 1500 (Suwaidan, 2010).

Therefore, this research attempts to shed some light on the factors influencing audit fees in Jordan. According to Suwaidan (2010), the audit market in Jordan can be characterized by a severe competition. As mentioned earlier this has forced the JACPA to interfere in the market by placing a minimum audit fees.

The choice of Jordan comes also from other important facts such as that Jordan enjoys a unique geographic location with stable political environment and runs a free-market economy. Second, it offers an attractive incentive package and provides an attractive climate to foreign Investors. Third, this has coincided with the ongoing privatization program adopted by the government in the early 1990s and the signing of agreements with the European Union (EU) and the World Trade Organization (WTO). Fourth, unlike most Arab countries, since the early 1990's, Jordan has applied both international accounting and auditing standards (IASs). As a result, a number of the big international audit firms entered the Jordanian audit market either on their own or as

partners to local audit firms. Finally, the presence of international audit firms, whether on their own or as affiliates with local audit firms, is expected to give foreign investors quality assurances over the proper allocation of their resources (Naser and Nuseibeh, 2007).

1.2 Objectives of the Study

The main objective of this research is to examine a number of factors that could impact the pricing of audit services in Jordan. More specifically, this research attempts to find the impact of the time lag between year-end and audit report date, corporate size, corporate complexity, corporate risk, experience and reputation of the audit firm, and whether the audit firm is a big 4 or not on audit fees for a sample of manufacturing companies listed in the Amman Stock Exchangefor the period (2011-2013).

1.3 Questions of the Study

There areseveral questions that are hoped to be answered throughout this study and they are as follow:

1. Is there a relationship between corporate size and audit fees?
2. Is there a relationship between corporate risk and audit fees?
3. Is there a relationship between corporate complexity and audit fees?
4. Is there a relationship between the time lag between year-end and audit report and audit fees?
5. Is there a relationship between whether the audit firm is a big 4 or not and audit fees?
6. Is there a relationship between the reputation of the audit firm and audit fees?
7. Is there a relationship between the experience of the audit firm and audit fees?

1.4 Importance of the study:

Most of the prior studies which presented empirical evidence of the effect of the attributes of audited companies on the audit fees, focused mostly on developed economies (for example, Haskins and Williams,

1988; Chan, Ezzamel, andGwilliam, 1993; Ezzamel,Gwilliam, and Holland, 1996; Iyer and lyer, 1996; Chung andNarasimhan, 2002; Ezzamel, Gwilliam, and Holland, 2002; Neimi, 2002; Simon and Taylor, 2002; Australia: Francis, 1984; Francis and Stokes, 1986.). While a limited number of studies have related to emerging economies (for example, in Jordon: Naser&Nuseibeh, 2007; Suwaidan, 2010; in Bahrain: Joshi and Al-Bastaki, 2000; in Qatar: Kutob and Al-Khater, 2004; in Bangladesh: WaresulKarim andMoizer, 1996; Hong Kong: Simon, Teo andTrompeter, 1992; Sandra and Patrick, 1996).Therefore, the importance of this study comes from the fact that there is a lack of studies about the pricing of audit fees in Jordan that focused only on manufacturing companies. The results of this research might be useful to audit firms so they would know what companies they should charge more and what companied should be charged less in exchange of the audit services they provide. The results might also be useful to companies in helping them to find out what to expect, whether they are going to pay high audit fees or low ones depending on their characteristics with regard to the variables addressed in this study.

1.5 Organization of the Study

The current study consists of six chapters. Chapter one outlines the objectives, questions and importance of the study. Chapter two provides theoretical background about the topic. Chapter three provides a review of previous empirical studies consistent with the current study. Chapter four discusses the methodology employed by the study to achieve its objectives. Chapter five provides the results of the study and examines its hypotheses, while chapter six summarizes the study and outlines its major implications.

Chapter two

Theoretical background

2.1 Auditing as a Phrase
2.2 Financial Audit
2.3 External Audit
  2.3.1 External audit process
  2.3.2 What is the benefit of the auditing process
  2.3.3 Limitations of the auditing process
  2.3.4 Independence of external auditor
  2.3.5 Auditor appointment
  2.3.6 Qualifications of external auditors
  2.3.7 Auditor's report
2.4 Internal Audit
2.5 Relationship Between Internal and External Audit
2.6 Audit Quality
2.7 Pricing of Audit Services
2.8 Auditing and Audit Practice in Jordan

The economic framework underlying this study is that audit fees reflect the costs of efficient auditors (Simunic and Stein, 1996). These costs vary considerably with variables such as the size, complexity, riskiness, and other variables which are undertaken by the study. The purpose of this chapter is to give an understanding of audit, external auditors, and the services provided by the external auditor, in order to fulfill the main purpose of the study which is to find out what factors are considered important in pricing audit services (measured by audit fees) in Jordan.

2.1 Auditing as a Phrase:

The word "audit" comes from the Latin word audire, meaning "to hear". (Flint, 1988) explains that the audit function has evolved in response to a perceived need of individuals or groups in society who seek information or reassurance about the conduct or performance of others in which they have an acknowledged and legitimate interest. So the auditing concept started to exist because these groups and individuals are not able to get those kinds of information and reassurance by themselves. In another meaning Auditing is a mechanism to enforce accountability and it plays a major role in keeping control not only in accounting but in every aspect of our lives. As (Normanton, 1996) said "Without audit, no

control; and if there is no control, where is the seat of power?" The term audit most commonly refers to audits in accounting, quality management, water management, and energy conservation. This study will talk about the audit in accounting (financial auditing) which will be explained in the following section.

2.2 Financial Audit:

Accounting information is the primary vehicle for managers to make assertions about the past performance, current conditions, and future prospects of their firms (Wallin, 1992). Auditing is as important as the generation of such information because in the absence of auditing, firm-specific information would be inaccurate. This would result, onone hand, in mismanagement of a firm's scarce resources. On the other hand, inaccurate information would mislead investors in their investment decisions, resulting in inefficient allocation of resources in the economy (Baiman at el., 1987). So financial auditing can be defined as process done to verify that the financial statements done by the management of the company are fairly represented and if they reflect the actual results of the company or not. As mentioned by Ricchiute (1992) auditing provides credibility to managerial disclosures, this credibility in turn

raises the firm's value. The standards not only require auditors to gather and objectively evaluate evidence throughout the audit, but also ask auditors to neither assume that management is dishonest nor presume unquestioned honesty (Popova, 2013).

It should be mentioned that audit can be divided into two types, internal and external audit and both will be discussed in this chapter. Auditors, both external and internal, make extensive use of analytical procedures as diagnostic tools. By employing analytical procedures, auditors identify areas which may contain errors that warrant investigation (Colbert, 1994). Thus, auditing conducted internally and/or externally, is a prerequisite for efficient allocation of resources at the micro and macro levels (Abdel-Khalik, 1993; Penno,1990).The following section provides a full discussion of external audit.

2.3 External audit:

Auditing is an important part in accountancy, it is a process done by an external independent auditor to verify that the financial statements done by the management of the company are fairly represented and if

they reflect the actual results of the company or not. External auditing gives a reasonable assurance to the users that the financial statements where prepared according the rules and regulations. The potential conflicts of interests among owners, managers, and other security holders create an environment in which an external auditor may contribute significant value to investors.

It is claimed that auditors have divided loyalties (Bazerman*et al.*, 1997; Jenkins and Lowe, 1999; Mayhew *et al.*, 2001;i hman*et al.*, 2006). They must serve owners and other external stakeholders, while simultaneously satisfying company managers. According to (Jenkins and Lowe,1999), auditors themselves view their divided loyalties in different ways. Some auditors primarily perceive themselves as “watchdogs” serving external stakeholders, while others primarily perceive themselves as clients’ “advocates”.

2.3.1 External audit process:

A financial audit process is normally done on an annual basis, before the company releases its financial statements to the public users. According to Larcker, (2011) the process consists of four stages. First, Planning and

risk assessment, this stage comes before the year-end; during this stage the auditor studies the type of business and the environment of the company. Second, Internal controls testing, because the internal control of the company is very important and its effectiveness can make the work of the external auditor either harder or easier, so during this stage the external auditor evaluates the internal control, and find out the amount of work that the external auditors have to do. Third, Substantive procedures, which comes after the year-end and it is the hardest and most important stage in the process, it involves collecting information and evidence that the management of the company has prepared the financial statements with reliability and according rules and standards. Then comes the fourth and the last stage of typical audit which is Finalization, within this stage the auditor reports to the management about any important matter that comes to his attention, evaluate the evidence collected in the previous stage, and makes his mind about what kind of opinion should be reported.

2.3.2 What is the benefit of the auditing process?

Companies in many countries do not have the choice of performing the external auditor not, it is actually required by law. As described earlier

the process of auditing is not easy and it takes a lot of work from the external auditor, so the auditing process can be costly not only for companies and their shareholders, but also for the society in general, because the money spent of this requirement can be spent more effectively somewhere else (Al-Awaqleh, 2010). So, the question that needs to be asked, what is the benefit of auditing? And more important, does this benefit exceed the cost or not?

To answer this question it must be known that having reliable information is very important to the users of the financial statements and for the society itself, investors use this reliable information to make accurate investment decisions, and make sure that their money is invested efficiently and in the right place. The society would benefit as well if the money is invested where it is most productive (lacker, 2011). Due to its importance, as mentioned earlier the financial statements must be checked and audited before released to the users, because if it was not, the providers of such unchecked financial statements might take the opportunity to benefit personally by misleading this information. So the benefit of performing the auditing process is that it secures the financial statements from being manipulated and makes

sure that they are free of any deception (Wallin, 1992). As a result a trust is built between investors and the financial statements of the audited company, and helps the investors rely on those financial statements to make their adequate decisions.

So as a conclusion we can say that the external auditing process is important for three kind of users; first, the management of the company, and it helps them to learn about the weaknesses of their company and if their internal control is effective or not. Second, regulators and it helps them understand the practices of the audited company and detect whether those practices comply with the rules and regulations. Third, investors, they use the audit report to know the economic position of the company and upon that they make the decision whether to invest in the company or not.

2.3.3 Limitations of the auditing process

The auditor as mentioned earlier provides an assurance that the financial statements are free of material misstatements, due to several factors this assurance can't be an absolute one and can only be reasonable, those factors are called limitations. One of the limitations

that an auditor faces is that some items in financial statements of a company are estimated and might have a level of uncertainty. As mentioned by Wallace, (1993) many estimates made by management rely on underlying, subjective management assumptions or assertions that are difficult, if not impossible, to substantiate. So in performing an audit in this area the auditing standards explicitly direct the auditor to assess whether, individually or in aggregate, accounting estimates. Another limitation is that the auditor gathers evidence through a process of selective testing; this means that not every detail of transaction has been verified by the auditor.

2.3.4 Independence of external auditor:

As mentioned earlier the role of audit is to provide an assurance that the financial statements are accurate, because many users rely on those financial statements to make investing decisions. As stated by Moore *et al*., (2006) independence is the only justification for the existence of accounting firms that provide outside audits; if it were not for the claim of independence, there would be no reason for outside auditors to exist, since their function would be redundant with that of a firm's inside auditors. Since it is the management's responsibility to prepare the

financial statements, independence in audit can be referred to as the relationship between the auditor and the management. And In order to ensure independence, the only relationship between the company and the auditor has to be the audit task (Romero, 2010).

After the 2000 scandals of Enron, WorldCom, etc. the Sarbanes-Oxley Act (SOX) of 2002 introduced rules to increase the independence. These rules include the prohibition to provide other services in conjunction with the audit, the rotation of the auditors, and conflicts of interest resulting from employment relationships (Romero, 2010). But it is also important for the auditors to keep a good relationship with the audited company, so on one hand; auditors should be able to establish trust with their client to perform an efficient audit. On the other hand, auditors are supposed to maintain an independent and skeptical attitude throughout the audit, to help them perform an effective audit (Popova, 2013).

2.3.5 Auditor appointment:

Even though the external auditors are paid by the company itself, the appointment of those auditors is up to the shareholders. When deciding to either reappoint the existing auditor, first, the audit committee

oversees the independence and the performance of the auditor and then reports its opinion to the board of directors, and then the final decision is made by the shareholders at the annual meeting (Larcker, 2011). To assure the best quality of audit, the audit committee reevaluates the audit fees depending on more than one variable. When the company is deciding on changing the existing auditor, the audit committee is also the one responsible to make this decision by recommending the top management whether the change of the auditor should be done, and if so, which firm should be considered. The auditorshould be someone that the client firm can trust, understands how the business operates, and be able to respond with new ideas. Therefore, it is very important for a company to analyze the cost and benefits of selecting a particular audit firm (Nazri*et al.*, 2012). And as Whittington *et al.*(1984) reported that the process of choosing an auditing firm has become more complex and the choice of an outside and international audit firm is based on a prior personal relationship with management or a recommendation from the company's banker or lawyer.

2.3.6 Qualifications of External Auditors:

The requirements for being an auditor are different from one country to another. But in general to be certified as an external auditor the accountant should reach a certain level of education and practical experience (Stanley and DeZoort 2007). In addition to the academic knowledge in accounting itself to be qualified as an auditor he/she should have an understanding of finance, law, business management and other topics.

2.3.7 Auditor's Report:

After going through all stages of financial audit a report is issued by the independent external auditors as a result of their external audit. The report includes an opinion on whether the information presented by the company is correct and free from material misstatements. This opinion is important to the users because it effects their decisions. As stated by Shaw, (1980) the audit is to do with accountability, and the audit report expresses an opinion on the accounts, the audit report lends credibility to the directors' financial reporting by validating the techniques of financial measurement and reporting adopted by them. As mentioned by Al-Thuneibat*at el*., (2008) the audit report is the medium of communication between the auditor and the users of the financial

statements. It represents the most important aspect of the audit process and the auditor uses it to convey the results of the audit process to the users of the financial statements. There are four common types of auditor's report; each type represents a different situation. The four types are as follows:

Unqualified Opinion:

This report is issued when the auditor sees that the financial statements of the audited company are fairly represented. The auditor issues an unqualified or also called a clean report, when he/she does not have any significant reservation on any of the information contained in the financial statements (Simunic, 1980). Although the clean report is a good thing, it does not reflect the health of the company; what it actually reflects is the health of the financial statements made by the company. Because it is the best kind of audit report a company can get, some companies rely on this report to attract investments (Hay *et al*. 2006).

The unqualified report indicates the following:

(1) The Financial Statements have been prepared using the International Accounting Standards (IAS)

(2) The Financial Statements comply with rules and regulations.

(3) There is adequate disclosure of all material matters relevant to the proper presentation of the financial information subject to statutory requirements.

(4) Any changes in the accounting principles or in the method of their application and the effects have been disclosed in the Financial Statements.

Qualified Opinion:

This kind of report is issued under one of two cases, either the auditor sees that the financial statements are materially misstated, but this misstatement does not have a huge effect of the financial statements. Or the second case is that the auditor is unable to get evidence about one of the account balances or a transaction, but this also does not have a severe effect on the financial statements. The qualified opinion is very similar to the unqualified one but it states that the financial statements are fairly presented with a certain exception of some information that is misstated (Mong and Roebuck, 2005).

Adverse Opinion

This report is issued when the auditor determines that the financial statements of an audited company are materially misstated and, when considered not to conform with GAAP. It is considered the opposite of

an unqualified opinion. It usually means that the information contained is materially incorrect, unreliable, and inaccurate in reflecting the financial position and results of the company's operations (Ireland, 2003). Investors usually do not accept a company's financial statements if the auditor has issued an adverse opinion, and usually request the company to correct the financial statements and obtain another audit report.

Disclaimer of Opinion:

This type of report is issued when the auditor tried to audit an entity but could not complete the work due to various reasons and does not issue an opinion.

The disclaimer opinion is issued under one of the following cases:

- When the auditor is not independent or when there is conflict of interest.
- When the limitation on scope is imposed by client, as a result the auditor is unable to obtain sufficient appropriate audit evidence.
- When the circumstances indicate substantial problem of going concern in client.
- When there are significant uncertainties in the business of client.

2.4 internal audit:

Internal audit is a process made within the company itself, it is very important for each company to have an internal audit department. Internal auditing is performed in diverse legal and cultural environments; within organizations that vary in purpose, size, and structure; and also by persons within or outside the organization

(Fadzil*et al.*, 2005). Internal auditors need to be out in front, leading the business units with regards to the internal control system and also focusing on strategic business objectives. Due to the importance of internal audit and internal auditors to the control system of the company, Sawyer and Vinten, (wow1996) mentioned that The internal auditors also need to establish themselves as vital cogs in their organizations, rather than as observers who watch from the periphery and wait for events to impact them.

The effectiveness of the internal audit process is very important for the company and it gives an assurance that the control system used by the company is effective. Van Gansberghe, (2005) explains that internal audit effectiveness should be evaluated by the extent to which it contributes to the demonstration of effective and efficient service

delivery, as this drives the demand for improved internal audit services. Based on the results of a consultative forum that focused on improving public sector internal audit, Van Gansberghe, (2005) identified perceptions and ownership; organization and governance framework; legislation; improved professionalism; conceptual framework; and also resources as factors influencing internal audit effectiveness.

2.5 Relationship between internal and external audit:

Through their audit process, the external auditors perform an assessment of the internal audit. Because as stated by Reinstein, *at el.,*(1994), to determine objectivity, the external auditor needs to know the organizational status of the officer to whom the internal auditors report; if the internal auditors have access to the audit committee or its equivalent; who hires and fires the auditors; if policies prevent auditors from auditing areas where relatives are employed or where they may themselves be assigned.

The coordination between internal and external auditors is very important to achieve the higher objective of the auditing process. Internal and external auditors should meet regularly over a long period

of time, giving each other mutual cooperation and support, by identifying and implementing activities to accomplish both professional groups' common objectives (Reinstein*at el*., 1994). A higher degree of coordination can lead to greater internal audit participation in the external audit process, Engle (1999) suggests that internal audit directors should work aggressively with external auditors to maximize their reliance on internal auditors as one way to develop more effective strategy of collaboration.

2.6 Audit Quality:

One common definition of audit quality is provided by DeAngelo(1981). She defined audit quality as "the market-assessed joint probability that a given auditor will both discover a breach in the client's accounting system, and report the breach". Due to the importance of audit quality; it can be a reason of changing the auditor. Beattie and Fearnley(1995) reported that dissatisfaction with audit quality is one of the most common reasons cited for choosing different auditors. A company may choose a higher quality auditor in order to provide more credible information to investors and creditors (Schwartz and Menon, 1985). They have suggested that firms demand a certain level of audit quality

which depends on how closely management and owners' interests are aligned (Simon and Francis, 1988; DeFond, 1992).

2.7 Pricing of Audit Services:

The audit market is different from other markets; first, it is seen by many to play an important and in some ways unique role in preserving transparency and improving the functioning of capital markets (Ball, 2001).Second, it is a competitive market, because a substantial portion of demand in the market is mandated, publicly traded firms are compelled to purchase audit services, and there are no services from outside the industry that can legally serve as substitutes (Gerakos and Syverson, 2014). Since it's a competitive market, it makes the decision of choosing an external auditor harder, but one of the most important factors that might affect this choice is the audit fees, as Fearnley and Beattie (2004) reported, the Accounting Review Board had received evidence that showed that competitive tendering has reduced audit fees, forced out waste and made firms focus on risk. Audit fees and some factors that might influence it will be discussed in this section.

Audit fees only include the amount paid to the external auditor in exchange to reviewing the financial statements of the client, and issuing the report with his/her opinion upon the fairness of the statements. Which means that the amounts paid for other services such as consulting and preparing the financial statements are not included in the definition of audit fees. Both the client and auditor are risk neuters and seek to maximize their own expected profits each period. Thus, the client's management seeks to maximize the expected profits of the financial reporting entity, while the auditor seeks to maximize the expected profits of the auditing firm (Simunic, 1980).

It is very important for both, the auditor and the client to agree on how much the service provided by the auditor will cost. As (Firth, 1997) stated, Knowledge of determinants of audit fees should be of interest and importance to suppliers and users of the audit services as well as the regulators, because, this would assist the auditors to examine their cost structure, predicting future fees and measure audit efficiency. It is also very important because audit fees is a very good indication of the auditor's independence (Abbott *et al*., 2012). Simunic(1980) asserts that audit fees are driven by those factors that cause an auditor to incur

more audit hours during the audit process. There is more than one way for audit firms to price their services and they are as follow:

- Time charge.
- Fixed fees.
- Same as last year with inflation.
- Competitive amounts, similar to what other companies charge.
- Value billing, depending on the value of the service to the client.

It is very important to take into consideration some important facts by the external auditor before he/she set their audit fees, those facts are as follow:

1. Time needed to complete the auditing process.
2. Number of employees needed.
3. The type of the auditing job, and the responsibility included
4. The ability of the audited company to pay the fees.

According to previous literature audit fees can be affected by many variables, throughout this section, some variables that influence the amount of audit fees are discussed separately as follows:

- Audit fees pricing and auditor size:

The audit firm size which could be measured by the total assets, and the market share of the firm, is one of the most important factors that have an effect on the audit fees. Choi *et al*.(2010) have found a positive relationship between the size of the audit firm and audit quality which would lead to a higher audit fees. Suwaidan (2010) says that since larger audit firms have more independence and better reputation it is expected that they would charge higher audit fees.

- Audit fees pricing and board of directors' size:

The board of directors plays an important role in monitoring and controlling managers. Although we might think that a larger board would be better for the organization, (Lipton and Lorsch, 1992; Jensen, 1993) argue that because of difficulties in organizing and coordinating large groups of directors, board size is negatively related to the board's ability to advise and engage in long-term strategic plans. (Beasley, 1996) also finds that the size of the board of directors significantly affects the likelihood of financial statement frauds. His results indicate that as board size increases, the likelihood of financial statement fraud also increases. Due to those facts, the board size is likely to affect the

financial reporting process, and the auditing process. If larger boards are less effective monitors of the financial reporting process (Beasley, 1996), then more audit hours are required and that would lead to higher audit fees.

- Audit fees pricing and audit committee independence:

An independent audit committee is likely to result in a more effective audit committee oversight of the financial reporting process, thus reducing the incidence of financial reporting problems (Blue Ribbon Committee, 1999; Abbott *et al*., 2004; Dechow*et al*., 1996; McMullen, 1996). Also as stated by (Yatim*et al*., 2006), an independent audit committee is better able to protect the reliability of the accounting process and promote objectivity on the part of the audit committee. Thus, this would lead to a stronger internal control, less work done by the external auditor, and lower audit fees.

Many others factors have been studied in the previous literature: audit effort (Simunic, 1980; Palmrose, 1986a; Simon and Francis, 1988; Haskins and Williams, 1988; Gist, 1992; Craswell*et al.,* 1995; Firth, 1997), auditing complexity (Simunic, 1980; Craswell*et al*., 1995; Choi *et al.,* 2008), auditing risk (Simunic, 1980; Chung and Lindsay, 1988; Francis and

Stokes, 1986; Craswell*et al.,* 1995; Simunic and Stein, 1996; Tsui, *et al.,* 2001; Houston *et al.,* 2005; Gul and Goodwin, 2010), auditor prestige and expertise (Simunic, 1980; DeAngelo, 1981; Francis, 1984; Palmrose, 1986; Francis and Stokes, 1986; Craswell*et al.,* 1995; Ireland and Lennox, 2002; Matthews and Peel, 2003; Peel and Roberts, 2003; Carson *et al.*, 2004; Cameran, 2005; Choi *et al.,* 2008), auditee and auditor relationship path (Simunic, 1984; Palmrose, 1986; Simon and Francis, 1988; Ettredge and Greenberg, 1990; Abdel-Khalik, 1990; Firth, 1997; Craswell and Francis, 1999; Huang *et al.,* 2009).

Along with the factors mentioned above, (Al-refai and Al-khateeb, 2011) have also suggested some important factors that need to be considered by both the auditor and the client when deciding on the appropriate audit fees:

1. To make sure that the audit fees are not low, so the auditor will not toleratein the auditing process.
2. To make sure that the audit fees is not determined by a person of which the work will be audited, because it is possible that this person might influence or negotiate the audit fees and the

auditing process and this would cause the auditor to lose his/her independence.

3. To make sure that audit fees are not being set depending on the results of the auditing process.
4. To make sure that the fees being paid to the external auditor matches his/her effort.

2.8 Auditing and Audit Practice in Jordan

Before 1944 the auditing in Jordan was undertaken mostly by Palestinian audit firms. The first audit office was established at that time by George Khader's firm. And after that other auditors from Palestine started moving to Jordan and the auditing profession in Jordan started to improve and increase in size. "By 1995, the number of audit firms and offices expanded to about 190" (Saddah, 1996). Because of the simplicity of the Jordanian economy, the rules and regulations for audit practices that Jordan has implemented in the 1960's were simple as well. "The professional codes were taken from British Companies Law, until the issuance of the Jordanian Companies Law 33/1962" (Obaidat, 2007). In 1998 Amman Stock Exchange (ASE) became an international recognized

market and the reason was that Jordan has adopted both the IAS and the International Standards of Auditing (ISA).

Currently audit practices in Jordan are governed by two laws, the Law of Audit Profession 1985 and The Companies Law 1997. The law of 1985 has set some criteria that the auditor has to meet to be recognized as a professional auditor, and set the requirements of the establishment of audit firms, and called for the establishment of the government Audit Bureau. "The Audit Bureau has authority to license auditors, approve audit laws and regulations in co-operation with the Jordanian Association of Certified Public Accountants (JACPA) for submission to parliament, and penalize auditors violating rules" (Naser and Nuseibeh, 2007). The establishment of the JACPA was alsorecommended by the law of 1985 as well to be a professional association of all licensed practicing auditors and responsible for the professional welfare of auditors. The JACPA was eventually established in 1988 and its responsibility is to propose audit laws and regulations to the Audit Bureau. The law of 1985 specifies that auditors should ensure that clients' books, records and accounts are prepared properly and issue a report on financial statements under professional guidelines, undefined

at that time, in which the auditors attest to the correctness of the financial statements (Naser andNuseibeh, 2007).

The Companies Law 1997 is the last enacted law regarding companies (Naser andNuseibeh, 2007). Under this law all kind of companies public shareholding companies, general partnerships, limited partnerships, limited liability companies, private shareholding companies, and foreign companies operating in Jordan are required to prepare annual audited financial statements and maintain sound accounting records and present annual audited financial statements in accordance with internationally recognized accounting and auditing principles. Auditors are appointed by the company's shareholders every year, they decide whether to elect a new auditor or renew the appointment of the already existing one.

Although the economic environment in Jordan differs from that in the developed countries, The Jordanian government and JACBA depend on the International Standards in auditing. The ISA are considered guidance to the external auditors and financial statements users since Jordan couldn't issue local standards to face any economic developments. And until now Jordan found that it is better to follow or adopt international standards on auditing then issuing local ones for the reason that local

standards are inadequate for foreign investment in Jordan. Along with some other reasons considered by Al-Awaqleh(2010) the big cost of issuing local standards, Jordan size, Jordan laws and legislations, the inability to research in this matter, and the adoption of those international standards by most of the world.

As the awareness of the investor increases by time, they come to know that they can't rely on the financial statements of a company if they were not audited by and independent auditor. And actually some companies rely on auditor reports to certify their information in order to attract investors, obtain loans, and improve public appearance. This means that auditing is a very important task that has to be performed. At the same time it gives more responsibility to the external auditors to make sure that the financial statements are audited correctly and the right audit report is issued. What makes the external auditors' job harder? Do some companies have to pay more auditing fees more than others and why? Those questions will be answered by the end of this study.

Chapter Three

Literature Review

3.1 Previous Studies

3.2 What Distinguishes this Study from Other Studies

3.3 Hypotheses of the study

3.1 previous studies:

As mentioned earlier, the subject of audit fees and its determinants has attracted the attentions of researchers over the years. The objective of this chapter is to provide a review of some of the previous empirical studies relevant to the current study. The studies reviewed are listed in chronological order, and then summarized in Table 3-1.

- **Yatim*et al.* (2006)**

"Governance structures, ethnicity, and audit fees of Malaysian listed firms"

The study examines the association between external audit fees, and board and corporate governance practices. Since Malaysian market is considered as an emerging market this research is motivated by the fact that the corporate governance practices within this market is different from the developed markets. The sample of the study consisted of736 firms listed on the Bursa Malaysia for the financial year ending in 2003. The study used a cross-sectional analysis to analyze these firms and a multiple regression analysis to estimate the relationships proposed in the hypotheses. The results indicate that external audit fees are

positively and significantly related to board independence, audit committee expertise, and the frequency of audit committee meetings. It was expected that firms whose directors are predominantly Bumiputeras are expected to pay relatively higher audit fees associated with poorer corporate governance practices, while the results show a negative relationship between external audit fees and Bumiputeraowned firms.

- **Al-Harshani (2006)**

"The pricing of audit services: evidence from Kuwait"

The study aims to investigate factors influencing the amount of external audit fees in Kuwait. The data were collected via survey from six audit firms in Kuwait during 2006. Each contacted audit firm was requested to provide information about a random sample of 15 audit engagements performed by the firm (with 2005 fiscal-year ends). Cross-sectional audit fee regression model was used. The results show that the amount of external audit fees is significantly influenced by the audit client size, liquidity ratio, and profitability ratio. But at the same time it does not show any relationship between the audit fees and the size of the audit firm or the number of audit locations.

- **Stewart and Kent (2006)**

"The Relation between external audit fees, audit committee characteristics and internal audit"

This study examines whether the existence of an audit committee, audit committee characteristics and the use of internal audit are associated with higher external audit fees. The sample consisted of 401 Australian publicly listed companies and the data was collected using a survey distributed to those companies. Three different regression models were used to test the hypotheses. The results show that the existence of an audit committee, more frequent committee meetings and increased use of internal audit are related to higher audit fees.

- **Besacier and Schatt (2007)**

"Determinants of audit fees for French quoted firms"

The study aims to investigate the factors influencing audit fees in France, the sample used in this study includes 127 French (non-financial) companies listed on the SBF 250 index in 2002. The study used six regression models to test their hypotheses. And their findings indicate that audit fees depend on firm size, firm risk, and the presence of two of the Big Four firms. When two Big Four firms audit company accounts, the fees charged (adjusted for company size) are significantly lower in comparison with those paid in the other cases.

- **Naser and Nuseibeh (2007)**

"Determinants of audit fees: empirical evidence from an emerging economy"

The study investigates the structure of audit fees in an emerging economy, Jordan. The factors taken by this study are corporate size, status of the audit firm, industry type, degree of corporate complexity, risk, corporate profitability, corporate accounting year-end (YEND) and time lag between YEND and the audit report date. The sample included the annual reports of all companies listed on Amman Stock Exchange on 2002. A cross-sectional linear ordinary least squares (OLS) regression was used to test the variables. The findings of the study indicate that corporate size, status of the audit firm, industry type, degree of corporate complexity and risk are the main determinants of audit fees. On the other side the results showed that profitability, time lag and the year-end are insignificant factors, and they don't affect the amount of audit fees.

- **Clatworthy and Peel (2007)**

"The Effect of Corporate Status on External Audit Fees: Evidence From the UK"

The paper examines the determinants of external audit fees of UK companies drawn from the quoted and the unquoted sector. And it also paper also provides new evidence on the effects of corporate failure and the persistence of the big four and mid-tier auditor premiums across the public and private corporate sectors. The data used in this paper is extracted from annual report of 51,429 companies. The data has been tested using a simultaneous equation methodology. The results of the study show that that quoted and unquoted public limited companies have significantly higher audit fees than their private limited counterparts.

- **Singh and Newby (2010)**

"Internal audit and audit fees: further evidence"

The study aims to examine the direction of the relationship between a firm's internal audit function and its external audit fees. This study was based on a previous study by Goodwin-Stewart and Kent (2006) which was made based on data collected in 2000 and showed a positive relationship between the existence of internal audit and the external audit fees. The sample used in this study was the top 300 publicly listed companies in Australia in 2005. The study used the OLS cross-sectional regression model to test its hypothesis. The results of the study

supported the results of Goodwin-Stewart and Kent (2006)and showed that the existence of an internal audit function in a firm has a significantly positive relationship with audit fees. And it also shows that the relationship became stronger since 2000.

- **Alali (2010)**

"Audit fees and discretionary accruals: compensation structure effect"

The study aims to examine the relationship between discretionary accruals (DAs) and audit fees and whether this relationship is affected by the chief financial officer's (CFO) compensation structure. The study used a sample of cross-sectional firms over the period 2000-2006. and a multiple ordinary least square regression models was used. The findings indicate that there is a positive and significant association between DAs and audit fees. Evidence shows that this relationship is significantly higher as CFO's bonuses increase and that this relationship is moderated as CFO's salaries increase.

- **Choi*et al.* (2010)**

"The Effect of Internal Control Weakness under Section404 of the Sarbanes-Oxley Act on Audit Fees"

The study was made to investigate the effect of the enactment of the Sarbanes- Oxley Act (SOX) in 2002 on audit pricing. The sample

consisted of 252 firms that received an “Ineffective” audit opinion and other firms that received clean audit opinion on the effectiveness of the internal control over financial reporting under Section 404 of SOX. A regression model was used to test the hypothesis. The results of the study show two things. First, they found that auditors charge significantly higher audit fees for all firms in the post-SOX period than in the pre-SOX period. Second, they found that auditors’ opinions on the weakness in internal control (WIC) are positively associated with audit fees.

- **Suwaidan (2010)**

"Some determinants of audit fees: a filed study on companies listed in ASE"

This study aims to investigate the effect of different variables (size, complexity, audit risk, sector, and the size of audit firm) on determining the audit fees. The sample consisted of 107 firms that were listed on Amman Stock Exchange (ASE) for the year 2003. A multiple regression model was used to analyze the data. The results show a positive relationship between all the variables suggested in this study and the pricing of audit fees, and it also shows that the size of the company is the most important one.

- **Suwaidan and Qasim (2010)**

"External auditors’ reliance on internal auditors and its impact on audit fees"

The purpose of this paper is to study factors that may influence the reliance of external auditors on internal auditors during the process of external audit, and it also studies the relationship if existed between this reliance and the external audit fees. The sample of the study consisted of 100 Jordanian external auditors to investigate the degree of their reliance on internal auditors, and cross-sectional multiple regression was used to analyze the effect of this reliance on audit fees. The results of this study aredivided into two parts. First, it shows that three things affect the degree of reliance by the external auditors on internal auditors and they are objectivity, competence and work performance respectively. Second, it shows that the size of the audited company is the main determinant of the audit fees, and there is no relation between the degree of reliance on internal audit and the fees paid to the external auditors.

- **Gul and Goodwin (2010)**

"Short-Term Debt Maturity Structures, CreditRatings and the Pricing ofAudit Services"

This study aims to investigate the relationship between short –term debt maturity structures, credit ratings and the pricing of audit fees. The sample used in this study is all rated U.S. listed firms for the years 2003 through 2006. A Descriptive Statistics were used to analyze the data collected and test the hypothesis of the study. The findings show that short-term debt is negatively related to audit fees for firms rated byStandard & Poor's, and also that the negative relation between short-term debt and audit fees is stronger for firms with low-quality credit ratings.

- **Redmayne*et al*. (2010)**

"The effect of political visibility on audit effort and audit pricing"

This paper was made to study whether political visibility has an effect on the effort made by external auditors and the pricing of audit fees. The sample of the study consisted of New Zealand public sector entities for the period 1998–2000. An OLS regression model was used to analyze the data and test the hypothesis of the study. The results show that audit fees are positively related to number of press mentions which was used

in the study as a proxy of political visibility, and that the hours spent by the auditor is also positively related to political visibility.

- **Redmayne*et al.*(2011)**

"The Association between Audit Committees and Audit Fees in the Public Sector"

The purpose of the study is to examine the association between the existences of an audit committee and audit fees. The model used in this study is the same as the model in Griffin et al. but they included an interaction term to capture possible joint countervailing effects between the audit committee and audit risk. The sample comprises New Zealand public sector entities for the period 1998–2000. The results of this study show that there is a positive association between audit committees and audit fees but no significant interaction terms for profit-oriented public sector entities. And that audit committees are associated with lower audit fees and interact with audit risk for public-benefit entities.

- **Wang and yang (2011)**

"Management Entrenchment, Agency Problem and Audit Fees"

The study was made to examine the relationship between audit fees and management entrenchment, and whether the association between audit fees and management entrenchment if existed, is contingent on firms' agency problems. The study used the OLS audit fee regression model which uses a set of variables to control for general cross-sectional differences in factors that affect audit fees. The sample of the study consisted of 2,510 firm-year observations from 2000 to 2004. The results of the study show that audit fees are positively associated with the management entrenchment, and shows that the positive relation between audit fees and the entrenchment index only exists for Jensen agency problem firms, which means that the association between audit fees and entrenchment provisions is contingent on firms' agency problems.

- **Calderon *et al.*(2012)**

"Past control risk and current audit fees"

The study investigates the effect of material weakness in internal control (MW) identified in prior periods on current audit fees. The authors hypothesize that the audit fees are driven by those past periods risks.The study used public disclosures of MW in the 10-K reports

compiled by Audit Analytics for the period from 2004 to 2009. The results show that current audit fees are strongly affected by past material weaknesses and that this effect lasts for at least three years.

- **Keane et al. (2012)**

"The effect of the type and number of internal control weaknesses and their remediation on audit fees"

The purpose of the study is to examine the impact of the type (same or different) and number of internal control weaknesses on audit fees. The sample of the study sample consisted of 9,122 firm-year observations involving 3,096 unique firms. And an ordinary least squares (OLS) regression was used to test the relationships. The findings indicate an incremental impact on audit fees of additional material weakness disclosures; firms that report the same material weakness pay higher fees than firms reporting a different material weakness in consecutive years.

- **El-Gammal (2012)**

"Determinants of Audit Fees: Evidence from Lebanon"

This study investigates factors that affect determining audit fees and provides evidence whether these factors are related to audit firm characteristics or the client firm characteristics. A sample of 80

respondents provided the empirical data for this research and the data was collected through a questionnaire. Descriptive statistics, means, standard deviation and Mann-Whitney U test were used to conduct a data analysis. The results show that all factors suggested in this study had an effect on the amount of audit fees and that the most important factor affecting determining amount of audit fees is whether the audit firm is one of the big four or not and the least important factor is the size of the audit firm based on the number of its employees.

- **Hamid and Ali (2012)**

"Effective Factors on Determination of Audit Fees in Iran"

The aim of the paper is to study the effective factors that determine the external auditor fees in Iran. The sample of the study consisted of the 80 largest market capitalization traded Iran firm. And the data was collected by distributing structured 50 items in Tehran stock exchange. A descriptive and inferential statistics were used to analyze the data and test the hypothesis. The results show a significant effect between the audit fees and the determinants undertaken by this study. And that the quality is most important effective factor.

- **Al-kasswna (2012)**

"The Impact of Information Technology on External AuditFees – A Field Study in the Hashemite Kingdom of Jordan"

Theobjective of this study is to investigate the relationship between information technology and the external audit fees. The sample of the study consisted of 60 audit offices in Jordan that has been randomlychosen. The data collection has been made through a questioner that has been distributed to those audit offices. SPSS Statistical Package and Service Solutions have been used to analyze data using the calculation of percentages and the means. The results show that the usage of information technology by the clients is a determinant of the audit fees paid to external auditors.

Table (3-1) below provides a summary of the previous studies.

Table 3-1
Literature Review
Summery

	Author/Year	Purpose	Sample	Methodology	Results
1	Yatim et al. (2006)	Find the association between external audit fees, board independence, and corporate governance practices	736 firms listed on the Bursa Malaysia for the financial year ending in 2003	Cross-sectional analysis	external audit fees are positively and significantly related to board independence, audit committee expertise, and the frequency of audit committee meetings
2	Al-Harshani (2006)	Investigate factors influencing the amount of external audit fees in Kuwait	Survey from six audit firms in Kuwait during 2006	Cross-sectional audit fee regression model	Audit fees is significantly influenced by the audit client size, liquidity ratio, and profitability ratio
3	Stewart and Kent (2006)	Examines whether the existence of an audit committee, audit committee characteristics and the use of internal audit are associated with higher external audit fees	401 Australian publicly listed companies	Three different regression models	The existence of an audit committee, more frequent committee meetings and increased use of internal audit are related to higher audit fees
4	Besacier and Schatt (2007)	Investigate the factors influencing audit fees in France	127 French (non-financial) companies listed on the SBF 250 index in 2002	Six regression models	Audit fees depend on firm size, firm risk, and the presence of two of the Big Four firms
5	Naser and Nuseibeh (2007)	Investigate the structure of audit fees in an emerging economy, Jordan	All companies listed on Amman Stock Exchange on 2002	Cross-sectional linear ordinary least squares (OLS) regression	Corporate size, status of the audit firm, industry type, degree of corporate complexity and risk are the main determinants of audit fees
6	Clatworthy and Peel (2007)	Examines the determinants of external audit fees of UK companies	Annual report of 51,429 companies	Simultaneous equation methodology	Quoted and unquoted public limited companies have significantly higher audit fees than their private limited counterparts
7	Singh and Newby (2010)	Find the relationship between a firm's internal audit function and its external audit fees.	300 publicly listed companies in Australia in 2005	OLS cross-sectional regression model	The existence of an internal audit function in a firm has a significantly positive relationship with audit fees

8	Alali (2010)	Examine the relationship between discretionary accruals (DAs) and audit fees	Cross-sectional firms over the period 2000-2006	Multiple ordinary least square regression model	positive and significant association between DAs and audit fees
9	CHOI et al. (2010)	Investigate the effect of the enactment of the Sarbanes- Oxley Act (SOX) in 2002 on audit pricing	252 firms that received an “Ineffective” audit opinion	Regression model	Auditors charge significantly higher audit fees for all firms in the post-SOX period than in the pre-SOX period
10	Suwidan (2010)	Investigate the effect of different variables (size, complexity, audit risk, sector, and the size of audit firm) on audit fees	107 firms that were listed on Amman Stock Exchange (ASE) for the year 2003	A multiple regression model	Positive relationship between all the variables suggested in this study and the pricing of audit fees
11	Suwaidan and Qasim (2010)	Relationship between the reliance of external auditors on internal auditors and the external audit fees	100 Jordanian external auditors	Cross-sectional multiple regression	There is no relation between the degree of reliance on internal audit and audit fees
12	Gul and Goodwin (2010)	Investigate the relationship between short –term debt maturity structures, credit ratings and the pricing of audit fees	All rated U.S. listed firms for the years 2003 through 2006	Descriptive Statistics	Short-term debt is negatively related to audit fees
13	Redmayne et. al (2011)	Study the effect of political visibility on the auditors effort and audit fees	New Zealand public sector entities for the period 1998–2000	OSL Regression model	Positive association between political visibility and both audit fees, and the auditor's effort.
14	Redmayne et. al (2011)	Study the effect of the existence of an audit committee on the pricing of external audit fees	New Zealand public sector entities for the period 1998–2000	Regression model	Positive association between audit committees and audit fees
15	Wang and yang (2011)	Examine the relationship between audit fees and management entrenchment	2,510 firm-year observations from 2000 to 2004	OLS audit fee regression model	Audit fees are positively associated with the management entrenchment
16	Calderon et al. (2012)	Investigate the effect of material weakness in internal control (MW) identified in prior periods on current audit fees.	public disclosures of MW in the 10-K reports compiled by Audit Analytics for the period from 2004 to 2009	Cross-sectional analysis	Audit fees are strongly affected by past material weaknesses

17	Keane et al. (2012)	Examine the impact of the type (same or different) and number of internal control weaknesses on audit fees	9,122 firm-year observations involving 3,096 unique firms	Ordinary least squares (OLS) regression	Incremental impact on audit fees of additional material weakness disclosures
18	El-Gammal (2012)	Investigates factors that affect determining audit fees	80 respondents provided the empirical data	Descriptive statistics, means, standard deviation and Mann-Whitney U test	All factors suggested in this study had an effect on the amount of audit fees
19	Hamid and Ali (2012)	Study the effective factors that determine the external auditor fees in Iran.	80 largest market capitalization traded Iran firm	Descriptive and inferential statistics	Significant effect between the audit fees and the determinants undertaken by this study
20	Al-kasswna (2012)	Investigate the relationship between information technology and the external audit fees	60 audit offices in Jordan	SPSS Statistical Product and Service Solutions	The usage of information technology by the clients is a determinant of the audit fees

3.2 What distinguishes this study from other studies?

Other than being the most recent study made on the subject, this study can be distinguished from the previous studies in two ways; First, it is more accurate to compare companies working within the same industry since they would have the same environmental factors. this study is one of the few studies that investigates a specific industry which is the manufacturing industry instead of including all the companies from all industries. Second, the sample of this study consists of all manufacturing companies over a three years period, which means that it has both a cross sectional and a time series analysis.

3.3 Hypotheses of the study:

After reviewing the previous literature seven different alternative hypotheses were set to be tested throughout this study, these are:

H1: There is a positive relationship between corporate size and audit fees.

H2: There is a positive relationship between corporate risk and audit fees.

H3: There is a positive relationship between corporate complexity and audit fees.

H4: There is a positive relationship between the time lag between year-end and audit report and audit fees.

H5: There is a positive relationship between whether the audit firm is a big 4 or not (Auditor's size) and audit fees.

H6: There is a positive relationship between the reputation of the audit firm and audit fees.

H7: There is a positive relationship between the audit firm experience and audit fees.

Chapter Four

Research Methodology

4.1 Population and Sample

4.2 Data Collection

4.3 Variables of the Study

4.3.1 Dependent variable

4.3.2 Independent variables

4.4 The Regression Model

The objective of the study is to find the impact of different variables on the pricing of audit fees. The purpose of this chapter is to discuss the methodology employed by the study to achieve its objectives.Thus, a discussionof the variables used in the study and the rationale for their possible relationship with external audit fees is made.In addition, the chapter provides a review of the data collection method, the sample of the study, and the regression model used to empirically examine the effect of the selected variables on audit fees.

4.1 Population and Sample

The population of the study consists of all manufacturing companies listed on the Amman Stock Exchange during the years 2011-2013, while the sample includes only manufacturing companies that meet the following conditions:

1. The company's annual report for the years 2011-2013 must be available.

2. The company must have disclosed audit fees in its annual report for the period 2011-1013.

4.2 Data collection

The data for this research are collected from the annual reports of manufacturing companies listed on the Amman Stock Exchange (ASE) over the period of 2011-2013 and from the most recent Companies Guide issued by the ASE. These sources are used to obtain information about the variables included in the study and their measurement.

4.3 Variables of the study

Variables are divided into two parts: first, dependent variable, which are usually affected by other variables and in this study is external audit fees paid by a client company. Second, independent variables, which are expected to have an effect on the dependent variable, are divided into two groups. The first group includes variables that are related to the audited company; the size of the audited company, its complexity, its risk, and the lag between the audit report and the end of the accounting year. The second group includes variables related to the audit firm itself; experience, reputation, and whether the firm is one of the "big four" or not. These factors are separately discussed in the following sections.

4.3.1 Dependent variable

Audit fees

As mentioned earlier in the study, audit fees is the amount of money paid by the audited company to the external audit firm in exchange with the audit services they provide. It should be mentioned that any other amounts paid to the audit firms by the company for non-audit services are excluded from audit fees (Suwaidan, 2010). What makes things easier now, that it is mandatory for the companies to disclose the audit fees they pay, so this piece of information is collected from the annual reports of each company in the sample for the period covered by the study.

4.3.2 Independent Variables

4.3.2.1 Independent variables related to the audited company:

Company size

Since the auditing fees are paid depending on the amount of time spent to complete the auditing process, and the amount of time depends mainly on the size of the audited company,thus, many previous studies showed that the size of the company is the most important factor that has an effect of the auditing fees. As mentioned by (Gerrard*et al.,* 1994) the relationship between audit fees and size of the audited company is

not linear, audit fees increase at a decreasing rate because the auditor is expected to achieve certain economies of scale in the supplying of audit services as auditee size increases. Consistent with previous studies in this regard, the total assets is used in this study to measure the company's size.

Complexity

A more complex audit client means a more diverse organizational structure, and it becomes harder to review transactions. So hypothetically, it is expected that as the audit client becomes more complex, more time and effort are needed to perform the external audit work. Because the effort done by auditor increases as the complexity of the audited company increases, this usually leads to higher auditing fees, (Suwaidan ,2010; Besacier and Schatt, 2007; Al-Harshani, 2006; Naser and Nuseibeh, 2007). Different variables were used by previous studies to represent complexity. For instance, some studies measure complexity by the number of audit locations visited by external auditors such as (Al-Harshani, 2006), because if the company has many branches that would increase the amount of effort done by the external auditors. The other way to measure the complexity is thru the percentage account

receivables of the company to its total assets, and percentage of inventories to the total assets. Because the inventories might be non homogenies and that means that the auditor faces a problem with allocating the indirect costs of those inventories and the evaluation and pricing of those inventories (Suwaidan, 2010). Due to the fact that auditing the inventories in a manufacturing company takes more effort than other types of companies, and since this study takes into consideration the manufacturing companies in Jordan, the methods used to measure the complexity in this study are based on, account receivables of the company to its total Assets, and the inventories to the total assets.

Risk

Auditing risk is the risk that the external audit firm will be held liable to third parties for damages related to misstatements in the audited financial statements (Al-Harshani, 2008). Audit risk usually measures the probability that the auditor might issue an unqualified report. There is more than one way to measure auditing risk, but the most popular one in terms of its use by previous studies is through the debt ratio which is computed as total liabilities to total assets, and it measures the

company's ability to pay off the incurred debt. The higher the debt ration the less credit rating the company has and the more effort the auditor has to do to avoid any potential litigation against them in the future. This is because "risk (debt ratio) is higher for companies that have endured financial losses, leading to higher possibility of bankruptcy or decline in stock price, and therefore larger probability of legal actions against both the client and auditor" (El-Gammal, 2012). As mentioned earlier, when the auditor puts more effort in getting the job done, the auditing fees will be higher.

The lag between the audit report date and the end of the accounting year

Even though accounting year-end for almost all Jordanian companies is December 31, most companies report their operation on March 31. This means that auditing companies will be busy during January and February. Due to this, auditing fees within these two months are expected to be relatively high. Some studies such as (Craswell*et al.*, 1995; Che Ahmed and Houghton, 1996; Ezzamel*et al.,* 1996) have called those two months a "busy season" variable and found that it has an effect on the audit fees.

The lag between the year end and the audit report, which is taken in this study into consideration, has been studied by many previous studies. Studies such as (Chan et al., 1993; Ezzamel*et al.,* 1996) found out that a short lag means lower audit fees or an efficient internal control system that made it easier for the external auditors to do their job. While a long lag might mean that the company has accounting problems and takes extra work from the auditor and that leads to higher audit fees.

4.3.2.2 Independent Variables related to the audit firm:

Experience

The experience of the audit firm is one of the most important factors that have an effect of the amount of audit fees paid in exchange of audit services. Many studies show that the more experience the audit firm has the higher the quality of its audit services and that would mean that it would charge higher audit fees(Ferguson, Francis & Stokes, 2003). Experience could be measured by the number of years the firm has been in the market.

Reputation

Previous studies such as (El-Gammal, 2012; Larcker and Richardson, 2004; Gonthier and Schatt, 2007; Carrera, 2003) have argued that there is a relationship between the reputation of the audit firm and audit fees. (Che-Ahmad and Houghton, 1996) says that "Firms which have invested in reputation capital (e.g., employee training programs and advertising), will require a high rate of return on its services and the only way to obtain this return is by placing high audit fees for their services. So this means that, the better the reputation of the audit firm the more is the demand on its audit services and the higher audit fees are (El-Gammal, 2012). The reputation of the audit firm in this research is measured by the percentage of firms audited by the audit firm.

Big Four (size of audit firm):

Due to their brand name and the higher audit quality they provide, companies would be willing to pay higher fees to be audited by one of the Big Four audit firms (Ernst and Young, Deloitte, PwC, and KPMG). (Simon *et al.*, 1992) found that the Big Eight or Big Five, now the Big Four audit firms receive premium fees in many countries compared to non-Big Four. "The Big Four are the biggest audit firms in the world and due

to their financial strength and expertise that they have they are able to provide higher quality audit" (El-Gammal, 2012). "On the other hand, the financial resources of the Big Four are much greater than that of the other firms and, consequently, in the case of a client firm's bankruptcy, investors/shareholders would be more willing to sue a Big Four firm in order to recover a portion of their investment" (Besacier and schatt, 2007). Based upon prior studies' findings done in many countries, this variable is expected to have a positive relationship between with audit fees.

4.4 The Regression Model

As mentioned earlier in this study the objective of the study is to find the impact of the time lag between year-end and audit report, corporate size, corporate complexity, corporate risk, experience and reputation of the audit firm, and whether the audit firm is a big 4 or not, on audit fees for the manufacturing companies listed on the Amman Stock Exchange. To accomplish this, a multiple regressions model is used. The following is the model:

$$FEES = \beta_0+\beta_1\ TA+ \beta_2\ AR/\ TA+ \beta_3\ INV/TA + \beta_4\ TL/TA + \beta_5\ TLAG +\beta_6\ EXP + \beta_7\ REP +\beta_8\ BIG4+ e$$

Where:

FEES = External audit fees paid by a client company.

Beta = The regression coefficient.

TA = Total Assets, Used to measure the size of the company.

AR/TA = Account receivables to Total Assets, used to measure the complexity.

INV/TA = Inventories to Total Assets also used to measure the complexity.

TL / TA = Total liabilities to Total Assets, measures the risk.

TLAG = The lag between the audit report and the end of the accounting year.

EXP = The experience of the audit firm.

REP = The reputation of the audit firm.

BIG4 = Whether the audit firm is one of the big four or not, a 1 is given if it is and a 0 if it's not.

e: = the error term.

The model above includes seven continues variables (the total assets, risk, two variables to measure complexity, time lag, experience and

reputation of the audit firm), and one dummy variable, which is BIG4, for this variable a 1 is given if the audit company is one of the big four audit firms, and a 0 is given if the company was audited by a firm other than the big four.

Chapter five

Analysis and Results

5.1 Descriptive Statistics

5.2 Normality and Multicollinearity

5.3 Regression Analysis

5.4 Discussion of Results

5.5 Testing the Hypotheses

5.1 Descriptive statistics:

Table 5-1 presents summery statistics (minimum, maximum, mean, and standard deviation), for the dependent and independent variables used by the study for the whole sample which included (66) manufacturing companies listed on the ASE. From the table it is noticed that the mean of audit fees is (JD 11150.41), and the standard deviation is (JD 11583.753). The standard deviation of audit fees is high which reflects the fact that there is a large variation in audit fees paid by the manufacturing companies included in the sample of the study. It is also shown in the table that there is also a large variation in the sizes of the studied companies as shown by the standard deviation of the total assets variable. Those facts are highly applicable to most of the continues variables in the study.

The economic year-end for almost all of the companies taken by the study is December 31, while the mean of the time lag between the year-end and the issuance of audit report is (62 days).It can also be seen from the table that the range in the time lag is (135 days) which is the difference between the minimum (9 days) and the maximum (144

days).However, the average time lag in the studied companies is shorter than that reported by (Ng et al., 1994) and (Sandra and Patrick, 1996) which is consistent to what was concluded by (Abu-Nasser and Rutherford, 1996) that the various users of corporate annual reports in Jordan viewed timelinessas an important criterion of useful corporate information. Forthe dummy variable undertaken by the study which is the size of the audit company, table 5-2 shows that more than 69% of the companies in the
sample have been audited by non-big four companies.

Table 5-1
Descriptive statistics

	N	Minimum	Maximum	Mean	Std. Deviation
Audit fees	198	2320	81200	11150.41	11583.753
Size (TA)	198	552375	1223269000	4.46E7	137121988.971
TIME LAG/days	198	9	144	62.39	25.162
RISK (TL/TA)	198	.00	2.28	.3622	.26739
COMP (AR/TA)	198	.00	.98	.1397	.12730
COMP (INV/TA)	198	.00	.65	.1898	.13602
Audit Firm Experience in Years	198	2	107	45.43	27.538
% of Companies Audited by The Firm	198	.02	15.00	.1712	1.06042
Valid N (listwise)	198				

Table 5-2
Audit Firm Size

	Frequency	Percent	Valid Percent	Cumulative Percent
None Big Four	137	69.2	69.2	69.2
Big Four	61	30.8	30.8	100.0
Total	198	100.0	100.0	

5.2 Normality and Multicollinearity:

An important part of the use of regression analysis is to establish that certain assumptions underlying its use are not significantly violated. One of the assumptions is that the variables are normally distributed. To assure that non-normality does not exist within the variables in this study, one strategy suggested by statisticians and adopted here is to transform the variables so that normality can be achieved. The log transformation was applied to both the dependent variable which is the audit fees and one of the independent variables which is the total assets that is used to measure the size of the client, to make sure that they do not deviate significantly from normality.

Another problem which often arises in conducting multiple regression analysis is the presence of multicollinearity between independent variables. This occurs when two or more exogenousvariables are highly correlated which makes it difficult to determine the individual contribution of each variable to the prediction of the dependent variable

(Barrow, 1988). According to Barrow (1988) multicollinearity does not represent a problem if one is interested in predicting the dependent variable from several independent variables, but it does when interpreting the individual influence of each independent variable. However, the latter is one of the major concerns of this investigation. Three symptoms of multicollinearity were pointed out by Barrow (1988, pp. 225):

(a) High correlation between two or more of the explanatory variables,

(b) High standard errors on the coefficients leading to insignificant *t* statistics,

(c) High value of R^2 in spite of the insignificance of the individual coefficients.

Several techniques have been suggested by statisticians to detect multicollinearity (see Kennedy, 1985, for the discussion of these techniques).One such techniqueis through the use of a correlation matrix. A high correlation between any pair of independent variables may indicate the presence of multicollinearity. However, the problem here is that there is no agreement on what is considered high. For example, according to Kennedy (1985) absolute correlation coefficients

of .8 or .9 indicate high correlation, while Anderson et al. (1993) consider an absolute correlation coefficient high if it exceeds .7 for any two of the independent variables. To assess the extent of this problem with respect to the current regression model, a complete correlation matrix incorporating all the variables was run. As noted in table 5-3, no high level of correlation was found between the independent variables.

Table 5-3

Correlation Matrix

	Log of TA	TIME LAG/days	RISK (TL/TA)	COMP (AR/TA)	COMP (INV/TA)	Audit Firm Experience/Years	% of Companies Audited by The Firm	Audit Size
Log of TA	1	-.093-	.132	-.054-	-.025-	.012	-.090-	.154*
TIME LAG/days	-.093-	1	.321**	.209**	.084	-.045-	-.047-	.231**
RISK (TL/TA)	.132	.321**	1	-.018-	.041	-.216**	-.080-	.062
COMP (AR/TA)	-.054-	.209**	-.018-	1	.112	-.062-	-.027-	.065
COMP (INV/TA)	-.025-	.084	.041	.112	1	-.119-	.020	.118
Audit Firm Experience/Years	.012	-.045-	-.216**	-.062-	-.119-	1	.170*	-.180*
% of Companies Audited by The Firm	-.090-	-.047-	-.080-	-.027-	.020	.170*	1	-.036-
Audit Size	.154*	.231**	.062	.065	.118	-.180*	-.036-	1

Another more popular technique for detecting multicollinearityis through the use of variance inflation factors (*VIF*), which are calculated by $(1 - R^2)^{-1}$, where R^2 is obtained by regressing each independent variable on all other independent variables (Kennedy, 1985). A *VIF*> 10 constitutes a potentially harmful degree of multicollinearity. This implies that R^2 is greater than 90%. Table 5-4 shows the values of the variance inflation factors. As seen, the values range from 1.039 to 1.286 suggesting that there is no multicollinearity problem in the regression model.

Table 5-4

The Values of Variance Inflation Factors (VIF)

Variable	VIF
Log of Total Assets	1.095
TIME LAG/days	1.286
RISK (TL/TA)	1.228
COMP (AR/TA)	1.070
COMP (INV/TA)	1.039
Audit Firm Experience in Years	1.139
Audit Size	1.146
% of Companies Audited by The Firm	1.044

5-3 Regression analysis:

After ensuring that the variables of the study are normally distributed and no multicollinearity exists, a regression model was estimated to identify the variables responsible for the variations of audit fees in the sample. Table 5-5 shows the results of the regression analysis.As it can be seen from the table that the model is statistically significant at a (1%)level of significance (F=54.682). The table also shows that the independent variables included in the model explain (69%) (Adj. R^2 = 68.6) of the variations in audit fees within the sample of the study.

As for the individual variables, the results of the regression analysis indicate the existence of positive relationship between the size of the company size and the audit firm size, and audit fees.

Table 5-5
Regression Results

Model	Standardized Coefficients	T	Sig.	Collinearity Statistics	
	Beta			Tolerance	VIF
(Constant)		12.727	.000		
Log of Total Assets	.656	15.697	.000	.913	1.095
TIME LAG/days	.034	.752	.453	.778	1.286
RISK (TL/TA)	.073	1.653	.100	.814	1.228
COMP (AR/TA)	.014	.344	.731	.935	1.070
COMP (INV/TA)	-.050-	-1.236-	.218	.962	1.039
Audit Firm Experience in Years	.018	.424	.672	.878	1.139
Audit Size	.405	9.475	.000	.872	1.146
% of Companies Audited by The Firm	.012	.294	.769	.958	1.044
F =54.682	Sig. = 0.00		Adj. R Square = .686		

As mentioned earlier the variance inflation factors (VIF) is a technique to indicate wither multicollinearity exists within the variables or not. This technique was applied to the variables, and as show in table 5-4 no harmful degree of multicollinearity exists within the variables undertaken by the study.

5.4 Discussion of Results:

According to the results of the regression analysis that was applied to the sample of the study, it is noticed that the size of the audited company is one of the most important determinants of audit fees. The results show that the size of the audited company has a positive relationship with audit fees, and this can be justified by the fact that the size reflects the working hours and the effort done by the auditor to complete the auditing process (Suwaidan, 2010). This is consistent with the results found by most of the previous studies (Suwaidan, 2010; Naser and Nuseibeh, 2007; Al-Harshani, 2006; Besacier and Schatt, 2007; Yatim*et. al*, 2006).

Another very important factor that has an effect on audit fees found by the results is the size of the audit firm. A significant positive relationship was found between the size of the auditor and audit fees.As mentioned earlier in the study, this positive relationship is due to the fact that the quality of audit provided by the Big four is higher than that provided by non-Big four firms. Previous studies such as (Suwaidan, 2010; Gul, 1999) have arrived to the same results regarding the size of the audit firm. No significant relationship was found between audit fees and the rest of the

variables undertaken by the study (Time lag between year-end and the audit report, audit risk, complexity of the client, experience, and reputation of the audit firm).

5.5 Testing the Hypotheses

As mentioned in Chapter Three,the hypotheses that were set to be tested throughout this study, are:

H1: There is a positive relationship between client size and audit fees.

H2: There is a positive relationship between corporate risk and audit fees.

H3: There is a positive relationship between corporate complexity and audit fees.

H4: There is a positive relationship between the time lag between year-end and audit report and audit fees.

H5: There is a positive relationship between whether the audit firm is a big 4 or not (Auditor's size) and audit fees.

H6: There is a positive relationship between the reputation of the audit firm and audit fees.

H7: There is a positive relationship between the audit firm experience and audit fees.

Thus, based on the results of the regression analysis reported in Table (5-5), two hypotheses are accepted.These hypotheses are: the size of the client **(H1)**and the size of audit firm**(H5)**. Table (5-5) provides summary results of testing the study hypotheses.

Table 5-6

Summary Results ofTesting Hypothesis

Hypothesis No.	Independent variable	Result of testing the hypo.
1	Client size	Accepted
2	Risk	Rejected
3	Complexity	Rejected
4	Time lag	Rejecedt
5	Auditor's size	Accepted
6	Auditor's reputation	Rejected
7	Auditor's experience	Rejected

Chapter six

Summary, Conclusions and Recommendations

6.1 Summary of Results and Conclusions

The objectives of this research is to find the impact of the time lag between year-end and audit report, corporate size, corporate complexity, corporate risk, time lag between year-end and the issuance of audit report, experience and reputation of the audit firm, and whether the audit firm is a big 4 or not on audit fees on a sample consisted of 66 of the manufacturing companies listed in Amman Stock Exchange for the years 2011-2013. To achieve the objectives of the studie a multiple regression analysis was applied. The results of the regression analysis can be summarized as follow:

1- There is a positive and significant relationship between the size of the audited company and audit fees. Thus, an important determinant of the pricing of audit services in Jordan is the size of the audited firm. This might be explained by the fact that the size of the company can be a proxy for the efforts exerted by the audit firm in auditing the company (auditing hours and auditing staff needed).

2- There is a positive relationship between the size of auditing firm and audit fees. In other words, the audit fees paid to the big four firms are greater than audit fees paid to non-big four. This would

indicate that there is a difference in the quality of audit services provided by the big four compared to those provided by non-big four firms.

3- No significant relationship was fount between audit fees and the rest of the variables undertaken by the study (corporate complexity, corporate risk, time lag, experience and reputation of the audit firm).

The outcome of the study offers an important insight into the factors that contribute in pricing of audit services in Jordan. One important conclusion of the current study is that the client size is the most important variable in the pricing of audit services for manufacturing companies in Jordan. This is consistent almost in all previous research whether in Jordan or in other countries (see chapter three). Thus, Jordan is no exception with respect to importance of client size in the pricing mechanism in the Jordanian audit market. It is worth noting that the size of client which was measured in this study by the client total assets can be considered as a proxy for other hidden variables. One of which is the audit hours spent by the auditor in auditing the company, and thus, the efforts excreted by him.

Another important conclusion of the study which is well-documented in the literature and applies to Jordan is (based on theregression model results) that there is a "Big four" premium. In other words companies audited by the Big Four pay significantly higher audit fees compared to those companies audited by other firms. This could suggest that there seems to be quality difference in the audit services provided by the Big four as compared by none Big four as perceived by audited companies. This may explain why such companies are willing to pay higher audit fees.

6.2 Recommendations of the Study

Based on the results of the study and its scope of coverage, the studyrecommendsthe following:

1. The topic of pricing of audit fees has received a great deal of attention by researchers in the literature, in particular, in developed countries, however, more research in this area in Jordan is warranted.

2. The setting of the audit market in Jordan is characterized by severe competition, thus a potential study on the impact of competition on the

pricing audit services is highly recommended. It could shed more light on the impact of Big four on audit pricing. In other words, is the results reached by the current study could be explained on the ground of quality differences between the Big four and other firms or based on possibility that the Big four are not subject to the same level of competition as other firms.

3. The current study focused on the pricing of audit services for manufacturing companies listed on the ASE, thus, the results of the study cannot be generalized to other companies listed in the market. Therefore, there is a need for future Jordanian studies to cover other sectors in the market. This will reveal whether the audit market in Jordan is homogeneous or heterogeneous with respect to factors influencing the pricing of audit service in Jordan.

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